

SUR TAX REFERENCE No 5 of 1981

Hon'ble MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE A.R.DAVE

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2. To be referred to the Reporter or not? Yes

5. Whether it is to be circulated to the Civil Judge?

No

Versus

Appearance:

MR DK MEHTA for MR KC PATEL for Petitioner

MR BB NAIK for MR MANISH R BHATT for Respondent No. 1

CORAM : MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE A.R.DAVE

Date of decision: 10/09/98

ORAL JUDGEMENT

(per R.K. Abichandani, J.)

By this Sur Tax Reference which relates to Assessment Years 1970-71 and 1972-73, the Income Tax Appellate Tribunal, Ahmedabad, has referred, for the opinion of this court, the following questions under sec. 18 of the Companies (Profits) Surtax Act, 1964 (hereinafter referred to as the Act) read with sec. 256(2) of the Income-tax Act, 1961.

1. "Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the Sur Tax Officer was well within his jurisdiction in passing the rectification orders for the Assessment Years 1970-71 and 1972-73."
2. "Whether, on the facts and circumstances of the case, the Tribunal was justified in holding that the orders passed in the two assessment years were valid in law?"

2. In respect of the Assessment Year 1970-71 the assessee had filed a return on 9.12.1970 for the accounting period from 1.4.1969 to 31.3.1970 showing the chargeable profit of Rs. 34,33,577/-. The Sur-tax Officer issued notice under sec. 6(1) of the said Act. In those proceedings, the assessee, by its letter dated 19.1.1971, intimated the S.T.O. that it had no objection if the reserve for additional depreciation and rehabilitation and development rebate reserve were not considered as reserve in computation of capital. In the order passed on 28.8.1974, the STO, taking the figure of general reserve of Rs. 1,61,83,570/- as on 1.4.1969, deducted the reserve for additional depreciation, rehabilitation and reserve for gratuity. No deduction was however made by the STO in respect of the proposed dividend for 1968-69 which was shown to have been deducted in the accounting year 1969-70 on page 20 of the balance sheet of the year ending 31.3.1969, being a sum of Rs. 29,25,000/-. That balance sheet, which is a part of the record, shows that certain sums were transferred from tax exempt profit reserve, statutory development

rebate reserve and profit and loss account to the general reserve, reaching the figure of Rs. 1,61,83,570/- which is shown as the figure of the general reserve as on 1.4.1969 from which the dividend amount which was proposed for the year 1968-69 in that accounting year came to be paid in the accounting year 1969-70. The dividend which was proposed so paid was, according to the Revenue, required to be deducted from the general reserve as on 1.4.1969 in respect of the said year. Since this was not done, the STO proceeded to rectify the mistake by issuing a notice under sec. 13 of the said Act to the assessee as to why the general reserve should not be reduced to the extent of Rs. 16,38,000/- on the first day of the accounting year 1969-70 before its inclusion in the computation of capital base. In the rectification order which was made on 7.4.1977, the STO found that there was a mistake committed in the assessment order dated 28.8.1974 and that the proposed dividend, which was to be distributed out of the general reserve, was not deducted from the balance of the general reserve as on 1.4.1969. It was held that the proposed dividend for the accounting year 1969-70 should be related back to the first day of the accounting year in view of the decision of the Supreme Court in CIT vs. Mysore Electrical Industries Ltd. reported in 80 ITR 566 and the general reserve as on 1.4.1969 should be reduced to that extent before including it in the capital base of the assessee. On behalf of the assessee, it was contended before the officer that on the first day of the previous year, that is, on 1.4.1969, the amount of proposed dividend was neither the liability nor a debt of the assessee company and, therefore, it was rightly included in the capital base of the company for the purpose of standard deductions. It was contended that there was no present liability existing on the first day of the previous year, that is, on 1.4.1969 in respect of the proposed dividend. The STO held that the objection of the assessee, whether the proposed dividend was reserve or not, being a matter in litigation, cannot be said to be a mistake apparent from the record was not acceptable since the recommendation of the directors about the dividend had the same character as that of a proposed dividend to be shown under the heading "Current Liabilities and Provisions" in the statutory form of the Balance Sheet. It was held that the amount proposed as dividend was for a known liability for which there could be no two opinions and, therefore, non-deduction of the proposed dividend from the general reserve was a mistake apparent from the record. It was held that the Board of Directors recommends dividend subject to the approval by the shareholders in the Annual General Meeting and when the

shareholders give such approval at a later date, the liability becomes due as on the first day of the accounting year. Therefore, the objection of the assessee that there was no liability on the first day of the accounting year was incorrect. It was held that the recommendation of the directors for distribution of the dividend when approved at the Annual General Meeting of the shareholders related back to the first day of the accounting year on the ratio of the decision of the Supreme Court in Mysore Electrical Industries Ltd. (supra). The STO, therefore, rectified the mistake by deducting the amount of proposed dividend from the general reserve. It will be noted that the amount of proposed dividend to be deducted from the general reserve as on 1.4.1969 was taken to be Rs. 16,38,000/-. The figure of general reserve of Rs. 1,61,83,570/- which was taken to be the figure as on 1.4.69 in the earlier order dated 28.8.74 was already reduced to Rs. 1,58,41,268/by deducting the amounts of reserves for additional depreciation and rehabilitation and reserve for gratuity and from this figure the amount of the proposed dividends was to be deducted and for that purpose, the STO, in his rectification order, took the figure of Rs. 16,38,000 as the proposed dividend which was required to be deducted while, admittedly, as per the balance sheet in the annual report 1969-70, the amount of dividend paid for 1968-69 in the accounting year 1969-70 was Rs. 29,25,000 which was shown to be deducted from the said general reserve figure of Rs. 1,61,83,510/- as on 1.4.1969. We may immediately note here that this discrepancy has surfaced for the first time at the hearing of this Reference and all throughout the rectification proceedings and the appeals before the first appellate authority and the Tribunal, the figure of the proposed dividend which was required to be deducted from the general reserve as on 1.4.69 was taken to be Rs. 16,38,000/- instead of the correct figure of Rs. 29,25,000/-. Against the rectification order dated 7.4.77 for the Assessment Year 1970-71, an appeal was preferred by the assessee under sec. 11 of the said Act before the CIT (Appeals) who, by his order dated 19.3.79, negating the contention of the appellant that the action of the STO in rectifying the mistake was not legal, held that there was a mistake of law apparent from the record which required to be rectified and that on merits, in the assessee's own case in respect of Assessment Years 1965-66, 1966-67 and 1968-69, the Tribunal had held against the assessee following the decision dated 13.12.76 of the Gujarat High Court in Income-tax Reference No. 4/73 in the case of Karamchand Premchand Pvt. Ltd. Following the ratio of that decision, the CIT (Appeals) held that the action of

the STO was right and no interference was called for.

3. As regards Assessment Year 1972-73, the assessee had filed return of chargeable profits under the said Act on 29.9.1972 showing chargeable profits of Rs. Nil in respect of the accounting period from 1.4.71 to 31.3.72. The figure of general reserve for the said accounting year as on 1.4.71 was admittedly Rs. 2,74,00,912/- as per the Balance Sheet for the accounting year 1971-72 which is on record. In the said balance sheet, admittedly, dividend amount of Rs. 39 lakhs was deducted from the general reserve as on 1.4.1971. However, in the assessment order dated 24.9.75, the STO, while deducting certain amounts which were not treated as reserve, omitted to deduct from the general reserve as on 1.4.1971, the amount of dividend of Rs. 39 lakhs which was proposed for the year 1970-71 and paid in the year 1971-72. The STO, noticing the mistake of not deducting the proposed dividend from the amount of general reserve as it stood as on 1.4.71, issued a notice under sec. 13 of the Act to the assessee for showing cause as to why the general reserve should not be reduced to the extent of Rs. 40,04,000/- on the first day of the accounting year before its inclusion in the computation of capital base. Contentions similar to those which were canvassed in response to the notice which was issued under sec. 13 in respect of the Assessment Year 1970-71 were also canvassed in response to this notice and, by a similarly worded order, for the same reasons which the STO had given for rectifying the mistake in respect of the Assessment Year 1970-71, the STO, by his order passed on the same date, that is, on 7.4.77, held that the proposed dividend which was required to be shown under the heading "Current Liabilities & Provisions" in the statutory form of balance sheet, was required to be reduced to that extent from the general reserve. He, however, proceeded to deduct the proposed dividend of Rs. 40,04,000/- as against the actual figure of Rs. 39 lakhs which was the dividend proposed for the accounting year 1970-71 and paid in the accounting year 1971-72 as reflected from the balance sheet of 1971-72 at page 20. We may again note that this discrepancy in the amount surfaced for the first time during the hearing of this Reference and even according to the learned counsel for the assessee, the amount which was deducted from the general reserve of Rs. 2,74,00,912/- which stood as on 1.4.71 was of Rs. 39 lakhs being the amount of dividend which was proposed for the year ending 31.3.1971. In the appeal which was preferred by the assessee against the rectification order, the CIT (Appeals), on the ratio of Karamchand Premchand's case (supra), by an identically worded order

as he had made in respect of the Assessment Year 1970-71, dismissed the appeal on 19.3.1979.

4. Against the two appellate orders by CIT (Appeals) made in respect of Assessment Years 1970-71 and 1971-72, the assessee appealed before the Tribunal under sec. 12 of the said Act. Before the Tribunal the assessee raised, through its learned counsel, the following contentions during the hearing of the appeals:

1. That the dividend proposed should form part of the general reserve and hence there was no mistake at all in the record.
2. In any case, even if there was a mistake, it was not one which could be rectified under sec. 13 of the said Act as the legal position was at best not clear, which would involve arguments and it was not possible to arrive at in a firm conclusion without a debate.

The learned counsel had relied upon the decision of the Supreme Court in Volkart Brothers and Others reported in 82 ITR 50 in support of his contentions.

5. The contention raised for the Department was that, in the assessee's own case for the Assessment Years 1965-66, 1966-67 and 1967-68, the Income Tax Tribunal had, following the decision of the Gujarat High Court in Karamchand Premchand Pvt. Ltd. (supra), held that the proposed dividend could not form part of reserves. It was contended that Rule 1 of the Second Schedule to the said Act specifically provided that such proposed dividend should not be treated as a reserve. It was contended on behalf of the Department that the decision in Karamchand Premchand's case (supra) was given by the High Court on 13.12.1976 while the STO had passed his orders under sec. 13 on 7.4.1977 and that such rectification orders could be passed in keeping with the decision of the jurisdictional High Court. The Department had also relied upon the decisions of this court in Parshuram Pottery Works Co. Ltd. v. D.R. Trivedi, Wealth-tax Officer, Morvi and Anr. reported in 100 ITR 651 and in Padmavati Jaykrishna v. Commissioner of Wealth-tax, Gujarat III reported in 105 ITR 115 in support of these contentions. The learned counsel for the assessee had in reply urged that the matter appeared to be debatable in spite of some decisions and that whether proposed dividend would form a part of the reserve or would be a mere provision was subject-matter of controversy in respect of which two opinions were

possible.

We have narrated the contentions raised before the Tribunal by the rival parties in detail with a view to focus upon the exact nature of controversy which the Tribunal was called upon to decide. This has become necessary because, as will be seen later on, the scope of contentions raised before this court on behalf of the assessee was much wider, and went beyond the controversy which actually was raised before the Tribunal and which the Tribunal decided in Para 8 of its order in the following terms:-

" In our view, after the decision of Their Lordships of Gujarat High Court in case of Karamchand Premchand, at least as far as this charge is concerned it cannot be treated as a question not settled. The position has been explained in 105 ITR 115 Padmavati Jaykrishna's case. After the decision of Their Lordships a rectification order passed in keeping with the same is, according to us, valid and, therefore, the S.T.O. was well within his jurisdiction when he passed the rectification orders.

We dismiss the assessee's appeals."

6. When the hearing commenced, the learned counsel appearing for the assessee had strongly contended that there was no mistake apparent on record in the making of the original order in respect of those two assessment orders requiring any rectification under sec.13 of the Act. It was contended that at the stage when dividend is proposed there was no "debt owed" till the company in its General Body Meeting accepts the recommendation in respect of the proposed dividend. It was, therefore, contended that, since it could not be known whether the recommendation would be accepted or not in respect of the dividend proposed out of the profits at the end of the accounting year, there being no liability arising as on the first day of the previous year immediately following such accounting year for which the dividend is proposed, the amount of proposed dividend could not be deducted from the general reserve as on the first day of the previous year. The learned counsel read the decisions of the Supreme Court in Vazir Sultan Tobacco Co. Ltd. v. Commissioner of Income-tax, A.P. & Ors. reported in 132 ITR 559 and in Commissioner of Income-tax, Mysore v. Mysore Electrical Industries Ltd. reported in 80 ITR 566 and proceeded to contend that at the time when the

original orders of assessment under the said Act were made in respect of these two years, the point was highly debatable and the subsequent decision of this court which settled the point was not available at the stage when the original assessment orders were made. After such detailed arguments on this point, the learned counsel submitted that he would not pursue the question as to whether the point was debatable and that he would confine his challenge to the following two contentions:-

1. That the Tribunal had fallen into an error in upholding the jurisdiction of the STO in spite of the fact that there was no mistake in the assessment order dated 28.8.74 for the Assessment Year 1970-71 and dated 24.9.1975 for the Assessment Year 1972-73.
2. In absence of any mistake which is a prerequisite condition for initiating proceedings under sec. 13 of the said Act, the rectification orders for both the years were not followed in law.

Elaborating these contentions, the learned counsel submitted that for the Assessment Year 1970-71 the relevant previous year would be 1969-70 covering the accounting period from 1.4.1969 to 31.3.1970 and therefore the Balance Sheet as on 31.3.1970 was relevant and any recommendation of dividend made in relation to the Balance Sheet on 31.3.1970 would be deductible from the profits as on 31.3.1970 and therefore could be deducted from the general reserve as on 1.4.1970 and not 1.4.1969. He argued that for deducting any proposed dividend from the general reserve as it stood on 1.4.1969 the relevant balance sheet would be as on 31.3.1969 and only the dividend proposed for 1968-69 which was to be paid out of the profits worked out at the end of that year i.e. on 31.3.1969 could be deducted from the general reserve as on 1.4.1969. He submitted that since the dividend of Rs.16,38,000 proposed as per the Directors' Report dated 8.10.1970 for the accounting year 1969-70 could be paid only in the next accounting year 1970-71, it was deductible, if at all, only from the profits worked out at the end of the year, that is, on 31.3.1970, and therefore from the general reserve as on 1.4.1970 if the profits without deduction thereof are transferred to the general reserve as on 1.4.1970, and not from the general reserve as on 1.4.1969. It was submitted that in respect of the first day of the previous year of the accounting year 1969-70, the relevant date was 1.4.1969 and from the reserve as it stood on 1.4.1969, the dividend proposed to be paid in that accounting year of 1969-70 would be for the

preceding previous year for which it was proposed. In other words, the dividend which was proposed for the accounting year 1968-69 and which admittedly as per the assessee's balance sheet was Rs. 29,25,000/- was relatable to the first day of the previous year 1969-70 and not the proposed dividend of Rs. 16,38,000/- which was recommended for the accounting year 1969-70 and could be paid only from the profits at the end of that accounting year as on 31.3.1970 which, if transferred to the general, would warrant deduction from the general reserve as on 1.4.1970. It was, therefore, contended that, by not deducting the said amount of Rs. 16,38,000, the STO did not commit any mistake.

As regards the A.Y. 1972-73, the learned counsel contended in the same vein that the amount of Rs. 40,04,000 recommended by the directors as the proposed dividend for the accounting year 1971-72 was payable only from the profits standing at the end of the said accounting year, i.e., as on 31.3.1972 and if profits are transferred to the general reserve, then from such general reserve as on 1.4.1972 and the said amount of Rs. 40,04,000/- could not have been deducted from the general reserve as on the first day of the previous year, i.e., as on 1.4.1971. He pointed out from page 20 of the Balance Sheet in respect of accounting year 1971-72 that the dividend which was proposed for the year ending 31.3.1971 was Rs. 39 lakhs which was relatable to the first day of the previous year, i.e., 1.4.1971 and not the sum of Rs. 40,04,000 which was relatable only to 1.4.1972. It was, therefore, contended that in the original assessment order, the STO did not commit any mistake when he did not deduct any proposed dividend from the general reserve as on 1.4.1971. It was submitted that thus, in the rectification order a wrong basis has been adopted by making deduction of the proposed dividend of Rs. 16,38,000/- as on 1.4.1969 being the first day of the previous year of 1969-70 and similarly a wrong basis even for the accounting year 1971-72 by deducting the proposed dividend amount of Rs. 40,04,000/- from the general reserve as on 1.4.1971. It was, therefore, contended that the rectification orders were bad on the ground that a wrong basis of deduction was chosen as the amounts which were not deductible as proposed dividends from the general reserves as on the first day of the previous years were sought to be deducted while purporting to rectify the original orders.

7. The learned counsel appearing for the Revenue contended that at no point of time till the midst of the reference did it occur to anyone that the figures taken

of the proposed dividend in respect of the two relevant years were not correct. It was submitted that the real issue involved before the Tribunal on which contentions were canvassed by both the sides was only whether there was a debatable point calling for no rectification since it could not be considered as a mistake and only an erroneous view out of the two possible views, or whether, in view of the clear provisions of Rule 1 read with its Explanation contained in the Second Schedule to the Act and the decision of this court, proposed dividend was required to be deducted from the general reserve as it stands on the first day of the previous year. It was contended that the grounds which are now sought to be raised after jettisoning the main question as to whether there was a debatable issue involved and, therefore, no mistake, were never raised before any authority so far, and they do not arise from the decision of the Tribunal which was rendered only on the points which were argued before it. It was also submitted that even if there is any error in taking the correct figure of the proposed dividend for reducing the same from the general reserve as it stood on the first day of the relevant previous year in respect of A.Y. 1970-71, that could be corrected by giving a direction to that effect to the Tribunal so that the assessee may not get the undue benefit of a deduction of a much lesser amount of proposed dividend, namely, of Rs. 16,38,000 as against the actual amount of dividend of Rs. 29,25,000 which was paid for the year 1968-69 in the accounting year 1969-70 and was deductible from the general reserve as on 1.4.1969. He also submitted that merely because erroneous figures are taken for the purpose of deduction, it would not show that there was no mistake in the original orders made by the STO in which he had omitted to make any deduction of the proposed dividends from the general reserves as on the first day of the relevant previous year in respect of these two years.

8. We may at the outset again emphasise that the controversy before the Tribunal which was raised by both the sides was entirely on the question as to whether the dividend proposed should form part of general reserve and that even if it did not, since that question was debatable at the relevant time when the assessment orders were made, it could not be said that there was a mistake committed by the STO which required to be rectified under sec. 13 of the said Act. The new dimension which is now given to the matter on behalf of the assessee in the midst of the hearing of this Reference for the first time focuses on the erroneous figures taken by way of proposed dividend in the rectification orders for the purpose of

making deductions from the general reserves standing on the first day of the relevant previous years. On the basis of these erroneous figures, it was argued that it should have been held that there was no mistake in the assessment orders because the assessing officer was not required to make deduction of such erroneous figures from the general reserves as on the first day of the relevant previous years and, therefore, there was no question of rectifying those orders on such ground.

9. Under Sec. 4 of the said Act, surtax was to be charged on every company for every assessment year commencing on and from the 1st day of April 1964 in respect of so much of its chargeable profits of the previous year or previous years, as the case may be, as exceed the statutory deduction, at the rate or rates specified in the Third Schedule to the Act. The words "chargeable profits" are defined in Sec. 2(5) of the Act so as to mean the total income of an assessee computed under the Income-tax Act, 1961, for any previous year or years, as the case may be, and adjusted in accordance with the provisions of the First Schedule. The expression "statutory deduction" as defined in Sec. 2(8) means an amount equal to 10 per cent of the capital of the company as computed in accordance with the provisions of the Second Schedule, or an amount of Rs. 200,000, whichever is greater, subject to the provisos to that definition with which we are not concerned in the present proceedings. A return of chargeable profits was required to be furnished as provided by Sec. 5 in the prescribed form before 30th of September of the assessment year. Under Sec. 6, the ITO is required to make the assessment after taking into account the relevant material and assess the chargeable profits and the amount of surtax payable on the basis of such assessment. Sec. 11 of the Act inter alia provides that an appeal lies to the Appellate Assistant Commissioner at the instance of any person objecting to the amount of surtax or who denies his liability or objecting to any penalty or fine imposed or objecting to an order refusing to allow the claim made by the assessee for a rectification under sec. 13 or amendment under sec. 14 of the Act. As provided in sub-sec. (4) of Sec. 11, the Appellate Assistant Commissioner is empowered to hear and determine the appeal and subject to the provisions of the Act, pass such orders as he thinks fit and such orders may include an order enhancing the assessment or penalty, provided that an order enhancing the assessment or penalty cannot be made unless the person affected thereby has been given a reasonable opportunity of showing cause against such enhancement. A person who is aggrieved by an order of

the Appellate Assistant Commissioner made under Sec. 11 or by an order made by the Commissioner in exercise of his revisional jurisdiction under Sec. 16 of the Act can appeal to the Appellate Tribunal as provided by Sec. 12 of the said Act. Under sub-sec. (2) of Sec. 12, even the Commissioner, if he objects to any order passed by the Appellate Assistant Commissioner under any provisions of the Act, may direct the ITO to appeal to the Appellate Tribunal against such order. As provided by sub-sec. (7) of Sec. 12, in hearing and making an order on any appeal under the said provision, the Appellate Tribunal is empowered to exercise the same powers and follow the same procedure as it exercises and follows in hearing and making an order in any appeal under the Income-tax Act.

10. Under Sec. 13 of the said Act, there is a provision made for rectification of mistakes and it, inter alia, lays down that, with a view to rectify any mistake apparent from the record, the Commissioner, the ITO, the Appellate Assistant Commissioner, and the Appellate Tribunal may, of his or its own motion, or on any application by the assessee, amend any order passed by him or it in any proceeding under the Act within four years of the date on which such order was passed. An amendment which has the effect of enhancing the assessment or reducing a refund or otherwise increasing the liability of the assessee shall not be made under the said provision unless the authority concerned has given a notice to the assessee of its intention so to do and has allowed the assessee a reasonable opportunity of being heard. Under Sec. 18 of the said Act, various provisions of Income-tax Act which are enumerated therein including sections 254 to 262 are made applicable with such modifications as may be prescribed as if they are the provisions of the said Act and the rules made thereunder.

11. As noted above, statutory deduction is to be computed in accordance with the provisions of the Second Schedule to the Act. The Second Schedule to the Act provides for rules for computing the capital of a company for the purpose of surtax. The said rule 1, to the extent that it is relevant for the purpose of the present reference, is reproduced hereunder:-

"1. Subject to the other provisions contained in this Schedule, the capital of a company shall be the aggregate of the amounts, as on the first day of the previous year relevant to the assessment year, of-

(i) xxx xxx xxx

(ii) its reserves, if any, created under the proviso (b) to clause (vi-b) of sub-section (2) of section 10 of the Indian Income-tax Act, 1922 (XI of 1922), or under sub-section (3) of section 34 of the Income-tax Act, 1961 (XLIII of 1961);

(iii) its other reserves as reduced by the amounts credited to such reserves as have been allowed as a deduction in computing the income of the company for the purposes of the Indian Income-tax Act, 1922 (XI of 1922), or the Income-tax Act, 1961 (XLIII of 1961);

(iv) xxx xxx xxx

(v) xxx xxx xxx

Explanation:- For the removal of doubts it is hereby declared that any amount standing to the credit of any account in the books of a company as on the first day of the previous year relevant to the assessment year which is of the nature of item (5) or item (6) or item (7) under the heading "RESERVES AND SURPLUS" or of any item under the heading "CURRENT LIABILITIES AND PROVISIONS" in the column relating to "Liabilities" in the "Form of Balance Sheet" given in Part I of Schedule VI to the Companies Act, 1956 (I of 1956), shall not be regarded as a reserve for the purposes of computation of the capital of a company under the provisions of this Schedule.

In clause (iii) of Rule 1, the "other reserves" would also include general reserve. As per the explanation to rule 1, any amount standing to the credit of any account in the books of a company as on the first day of the previous year relevant to the assessment year which is of the nature of any item including the one under the heading "current liabilities and provisions" in the column relating to "liabilities" "in the form of balance sheet" given in Part I of Schedule VI to the Companies Act, 1956, was not to be regarded as a reserve for the purpose of computation of the capital of a company under the provisions of the said Second Schedule. The Form of Balance Sheet prescribed in Schedule VI of the Companies Act, 1956 as required by the provisions of Sec. 211 of the Act requires the company to mention its "Current

Liabilities and Provisions". Under that heading there is the sub-heading "B. Provisions" below appears the item of "proposed dividends" at Serial No. 9. It is, therefore, clear that the proposed dividends is the nature of item identified by the explanation to rule 1 of the Second Schedule which cannot be regarded as a reserve for the purposes of computation of the capital of a company under rule 1 of the Second Schedule. In this context, we may note that under sec. 205 of the Companies Act, it is, inter alia, provided that no dividend shall be declared or paid by a company for any financial year except out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-sec. (2) thereof or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with those provisions and remaining undistributed. It will, thus, be seen that the dividend can be paid only out of the profits of the company in the year for which it is declared. The profits of the company would be worked out at the end of the relevant financial year and, therefore, there can arise no question of payment of any proposed dividend before such profits are worked out at the end of the financial year. This is the rationale behind the provision made in the explanation to rule 1 which requires that proposed dividends will not be regarded as reserve, because, the profits from which they ought to go out at the end of the relevant financial year, strictly speaking, would not be available for transferring them to the general reserve. Thus, if a dividend is recommended for the financial year 1968-69, then it is required to be paid out of the profits of the company for that year which would be worked out at the end of the year, that is, on 31.3.1969 and if, without deducting such proposed dividend from the profits, they are carried to the general reserve as on 1.4.1969, then such amount of the dividend proposed for the year 1968-69, would not be regarded as a part of the general reserve as it stood on 1.4.1969 and will have to be deducted therefrom under the said Rule 1. It therefore follows that the proposed dividend which is required to be deducted from the general reserve as it stands on the first day of the previous year is necessarily a dividend proposed for the earlier accounting year which was required to be paid from the profits worked out as at the end of that year and in the event of its not being deducted, and the profits being transferred to general reserve, it was required to be deducted from the general reserve as it stood on the first day of the previous year immediately following the end of the financial year for which the

dividend was recommended and was to be paid out of the profits of that year.

One thing that clearly stares from the provisions of rule 1 read with the explanation is that the proposed dividend can never be regarded as reserve. It therefore follows that when a dividend is proposed with a decision of the directors to pay it from the general reserves, then such proposed dividend cannot be regarded as a part of that general reserve as it stands on the first day of the previous year because it ought to have been paid out of the profits as worked out on the day immediately preceding that first day of the previous year. If this legal position is kept in mind and the original assessment orders made by the STO on 28.8.74 in respect of the Assessment Year 1970-71 and on 24.9.75 in respect of the Assessment Year 1972-73 are examined, it would become at once clear that from the figure of the general reserve of Rs. 1,61,83,570 as it admittedly stood on the first day of the previous year, that is, 1.4.1969 as per the balance sheet for the year 1969-70, no deduction whatsoever was made in the original order of assessment, for the proposed dividend. As per the balance sheet for the Financial Year 1969-70, admittedly, an amount of Rs. 29,25,000 was shown therein to have been deducted from the general reserve being the amount of dividend which was proposed for the year 1968-69 and which ought to have been paid at the end of that year out of the profits of the company as worked out on 31.3.1969. But, since the profits were transferred to the general reserve account with a rider that the proposed dividend of Rs. 29,25,000 would be paid out of the general reserve, when accepted by the General Meeting of the shareholders, the said amount of Rs. 29,25,000 could never have been regarded as a part of the general reserve of Rs. 1,61,83,570 as it stood as on 1.4.1969 in the balance sheet. In the return which was required to be filed under the Act in the prescribed form being Form No. 1 appended to the rules framed under the said Act, by virtue of rule 5 thereof in Part III which deals with computation of statutory deductions, item 8 required certain deductions to be shown which, inter alia, included the amount of any such reserve as was not to be taken into account in computing the capital under the Second Schedule to the said Act. This takes us back to the explanation to rule 1 to the said Second Schedule under which the proposed dividend was not to be regarded as reserve. It would appear that the assessee did not show any such deduction of the proposed dividend in the said item of the Part III of the return while computing the statutory deductions. This might have led to the omission on the part of the

Assessing Officer from deducting the amount of the proposed dividend of Rs. 29,25,000 from the general reserve of the company as it stood on 1.4.1969. If it was shown in the return of surtax as per the balance sheet as it ought to have been, the contentions of the assessee would not have been to the contrary in the proceedings that took place so far at various levels. It therefore becomes clear that the STO, while making the order on 28.8.1974 in respect of the Assessment Year 1970-71 relevant to the accounting period 1.4.1969 to 31.3.1970, omitted to make a deduction of the proposed dividend from the general reserve as on 1.4.1969, which he was required to make by virtue of the provisions of rule 1 read with its explanation of the Second Schedule to the said Act. This omission was clearly a mistake of law and there was no question of any debatable point involved in the face of the clear provisions of the Explanation to rule 1, as noted above.

12. Even as regards the Assessment Year 1972-73 the relevant accounting period of which was from 1.4.1971 to 31.3.1972, we find from the assessment order that, while taking the general reserve of the company as on 1.4.1971 being the first day of the previous year at Rs. 2,74,00,912, the Assessing Officer did not deduct the dividend proposed for the year ending 31.3.1971 which was payable from the profits as worked out at the end of the accounting year on 31.3.1971 and when the profits were transferred to the general reserve as on 1.4.1971 with a note that the dividend recommended for the year ending 31.3.1971 was required to be paid from the general reserve as and when accepted by the general body. Obviously, in view of the explanation to rule 1, any proposed dividend which was required to be paid from the profits of the year ending 31.3.1971, could not have been regarded as a reserve and ought to have been deducted from the general reserve of Rs. 2,74,00,912 as it stood on the first day of the previous year, that is, on 1.4.1971. The dividend which was proposed for the year ending 31.3.1971 admittedly was Rs. 39 lakhs as per the assessee's balance sheet (page 20) and it was required to be deducted from the said general reserve. The said amount of Rs. 39 lakhs which was proposed as the dividend for the year ending 31.3.1971 was, as per the Directors' Report dated 26.10.1971, in the event of it being approved at the ensuing general meeting, required to be paid out of the general reserve which means it was to be paid from the general reserve as on 1.4.1971. The Assessing Officer not having deducted any amount of proposed dividend from the general reserve as on 1.4.1971 committed an obvious mistake of law by ignoring the

provisions of the explanation to rule 1 which required such proposed dividend not to be regarded as reserve.

13. The omission in making the deduction of proposed dividend from the general reserve as on the first day of the previous year in respect of the both these years is so glaring from the original orders of assessment that there hardly would be any debatable point on the issue once the explanation to rule 1 is kept in mind. Therefore, there was sufficient justification for the STO to rectify the mistake by invoking the provisions of sec. 13 of the said Act. In Vazir Sultan Tobacco Co. Ltd. (supra), the Hon'ble Supreme Court, while considering rule 1 of the Second Schedule to the said Act, following its earlier decisions in CIT v. Century Spinning and Manufacturing Co. Ltd. (24 ITR 499) and Kesoram Industries and Cotton Mills Ltd. v. CWT (59 ITR 767), held that a mass of undistributed profits cannot automatically become a reserve and that a clear conduct on the part of the directors in setting apart a sum from out of the mass of undistributed profits avowedly for the purpose of distribution as dividend in the same year would run counter to any intention of making that amount a reserve. It was held that an amount set apart by the directors of a company for liability to taxation in respect of the profits which it had earned during the year will have to be regarded as a provision for a known and existing liability, the quantification whereof has to be done later, and cannot be regarded as a "reserve". It was further held that sec. 217 of the Companies Act, 1956, and Regulation 87 and Table A in Schedule I to that Act, read together, clearly show that creating reserves out of the profits is a stage distinct in point of fact and anterior in point of time to the stage of making a recommendation for the payment of dividend and the scheme of the provisions suggests that an appropriation made by the Board of Directors by way of recommending a payment of dividend cannot, in the nature of things, be a reserve. Appropriation made by the directors for the proposed dividend does not constitute "reserve" and the concerned amounts so set apart would have to be ignored or excluded from capital computation. In the said case, where after accounts for the current year 1972 were finalised, the directors transferred out of the profits a certain sum to the general reserve of the company without making any provision for the proposed dividend but recommending a dividend which was declared at the annual general meeting and paid thereafter, it was held that the dividend so declared had to be excluded from the general reserve while computing the capital of the assessee as on 1.1.1973, for the Assessment Year 1974-75.

14. In Mysore Electrical Industries Ltd. (supra), while considering the said rule 1 of Schedule II of the said Act in a case where out of the profits of the company for the accounting period ending 31.3.1963, the directors of the company appropriated certain amounts towards the reserves on 8.8.1963 and where the question was whether such amounts could be included in computing the capital of the respondent as on 1.4.1963 under the said rule for the purpose of statutory deduction for the Assessment Year 1964-65, the Supreme Court repelled the contention of the Department that since the appropriations were made on 8.8.1963, they could not be treated as components of capital as on the first day of the previous year, namely, 1.4.1963 which was the beginning of the accounts for the new year. It was held that the determination of the directors to appropriate the amounts to the three items of reserve on 8.8.1963 had to be related to 1.4.1963, that is, beginning of the accounts for the new year and had to be treated as effective from that date. It was held that the three items of reserve were, therefore, required to be added to other items for computation of the capital of the respondent as on 1.4.1963 under the said rule.

15. As noted above, the rectification orders were made under sec. 13 keeping in view the ratio of the decision of the Supreme Court in Mysore Electrical Industries Ltd. (supra). The appellate orders against these orders made under sec. 11 of the said Act by the CIT (Appeals) took note of the decision of the Tribunal in the assessee's own case for the earlier years in which the Tribunal had held against the assessee relying upon the decision of the Gujarat High Court in Karamchand Premchand's case (supra) decided on 13.12.1976. The case of Karamchand Premchand Pvt. Ltd. was carried to the Supreme Court and the Supreme Court in their decision reported in 200 ITR 268 in Karamchand Premchand P. Ltd. v. CIT, while construing the provisions of the said rule 1 and the explanation to it, in terms, held that the appellate order passed by the Tribunal in a surtax case, without taking note of the explanation to rule 1 of Schedule II to the said Act, could be rectified by the Tribunal under sec. 13 of the said Act. It was held that the amounts set apart for proposed dividends, profit sharing, bonus, pension scheme, were not 'reserves' and could not be included in the computation of the capital of the assessee under the provisions of rule 1 in Schedule II to the said Act. Thus, the fact that the Assessing Officer had rendered his orders of assessment without taking note of the aforesaid explanation to rule 1 in Schedule II was undoubtedly a ground for

rectification of the order under sec. 13 of the Act since it was a mistake apparent from the record. Even when the decision in Karamchand Premchand's case (supra) was rendered by the jurisdictional High Court, it was only a declaration of the law as it already existed.

In S.A.L. Narayana Row, Commissioner of Income-tax, Bombay City & Anr. v. Model Mills Nagpur Ltd. reported in 64 ITR 67 where the levy of additional tax on excess dividend was held to be illegal by the High Court and therefore an application for refund of the additional tax was made, relying on that decision of the High Court but the ITO declined to accede to the request on the ground that the assessment was completed long before the judgment was pronounced by the High Court by which the levy of tax on excess dividend was illegal, the Supreme Court upheld the decision of the Bombay High Court in which the ITO was directed to revise the order and rectify the mistake. In Kil Kotagiri Tea and Coffee Estates Co.Ltd. v. Income-tax Appellate Tribunal and others reported in 174 ITR 579 the Kerala High Court held that an order of assessment based upon an interpretation or application of law which is ultimately found to be wrong in the light of judicial pronouncements rendered subsequently, discloses a mistake apparent from the record. The Karnataka High Court in Mysore Cements Ltd. v. Deputy Commissioner of Commercial Taxes reported in 116 CTR 284 observed that it was needless to point out that when a point is covered by a decision of the Supreme Court or concerned High Court, either rendered prior to or subsequent to the order proposed to be rectified, then the point ceases to be a debatable point and it also ceases to be a point requiring elaborate arguments or detailed investigation/inquiry. The Andhra Pradesh High Court in B.V.K. Seshavataram v. Commissioner of Income-tax reported in 124 CTR 332, following the ratio of the decision of the Supreme Court in S.A.L. Narayana Row (supra) came to the conclusion that a subsequent decision can form the valid basis for rectifying an order of assessment under sec. 154 of the Income-tax Act, 1961. The Madras High Court in M.K. Kuppuraj v. CIT & Anr. reported in 128 CTR 407 is also of the view that the assessment made contrary to judgment subsequently rendered by a jurisdictional High Court constitutes an error on the face of the record amenable to rectification proceedings under sec. 154 of the Income-tax Act, 1961. The subsequent decisions of the jurisdictional High Court do not enact the law but declare the law as it always was and, therefore, there is a fallacy in the contention which was sought to be raised on behalf of the assessee

initially. As noted hereinabove, there was no debatable point existing at the time when the assessment orders were initially made. In fact, in our opinion, apart from the fact that the rule 1 and its explanation came to be considered later on by the jurisdictional High Court, the fact remains that the explanation to rule 1 was absolutely clear to indicate that the proposed dividend which was an item identified from the Form prescribed under the Companies Act under the heading "provisions" could never be regarded as a "reserve". Therefore, even on the reading of rule 1 and explanation itself, there was no scope for any doubt over the said proposition that the proposed dividend was not to be regarded as a reserve for the purpose of rule 1 while computing the capital of the company on the first day of the previous year. In our view, therefore, the Assessing Officer, by not at all deducting the provisional dividends which were required to be deducted from the general reserve of these two years, completely overlooked the explanation to rule 1 and thereby committed a mistake apparent from the record which required to be rectified under sec. 13 of the said Act. In this view of the matter, the Tribunal was justified in holding that the STO was well within his jurisdiction in passing rectification orders under sec. 13 of the said Act for the Assessment Years 1970-71 and 1972-73.

16. It will be noted from the record that the only question which was argued before the Tribunal was whether the dividend proposed should form part of the general reserve and hence there was no mistake at all in the record and even if there was a mistake, it was not one which could be rectified under sec. 13 since the legal position was, at best, not clear and was debatable. The Tribunal held that, after the decision of the Gujarat High Court in Karamchand Premchand's case (supra), a rectification order passed in keeping with the same was valid and, therefore, the STO was well within his jurisdiction when he passed the rectification orders. No contention was raised before the Tribunal by the assessee for the Assessment Year 1972-73 that the rectification was done by taking a wrong figure of Rs. 40,04,000 as on 1.4.1971 being the first day of the previous year instead of the proposed dividend of Rs. 39 lakhs which was required to be deducted from the general reserve on 1.4.1971. Nor was it ever contended by anyone before the Tribunal that for the Assessment Year 1970-71 also the figure of Rs. 16,38,000 was wrongly deducted from the general reserve as on the first day of the previous year, that is, 1.4.1969, instead of Rs. 29,25,000. Since no one disputed the correctness of the figures before the

Tribunal, it was not called upon to give any decision as to what figures ought to have been deducted and had simply rested its decision on the contentions which were raised before it and held that there was a mistake committed by the Assessing Officer in not deducting the proposed dividend which was required to be rectified in view of the legal position settled by the decisions of the jurisdictional High Court. That is the only question of law arising from the order of the Tribunal and referred to this court which is required to be answered by this Court. The validity of figures could have been checked up by reference to the Balance Sheet for the relevant years, which exercise was never attempted by any side even before the Tribunal. No one pointed out any mistake in taking the amount of proposed dividend which was required to be deducted from the general reserve as on the first day of the previous year in respect of these two years, as was demonstrated before us - by both the sides - either to the rectifying officer for setting it right or before the appellate authorities under sec. 11 or 12 of the said Act. What course, if any, is now open for the parties or the Tribunal need not be charted by us. We only hold that the STO did have jurisdiction to rectify the mistake of not deducting the proposed dividends which were required to be disbursed from the general reserve as on 1.4.1969 for the Assessment Year 1970-71 and as on 1.4.1971 for the Assessment Year 1972-73 as was required to be done for working out the capital under rule 1 read with its explanation contained in the Second Schedule of the said Act and that he committed irregularity in exercise of his jurisdiction by deducting wrong figures of proposed dividends instead of the correct figures.

17. The Balance Sheets of the relevant accounting years 1969-70 and 1971-72 admittedly show that the amounts of dividends were deducted from the general reserve that stood as on the respective first day of the previous year. This was, however, in all probabilities, not done in the return of surtax and that is why the original orders did not reflect any similar deduction from the general reserve as on the first day of the previous year, entirely overlooking the explanation to rule 1. This was a mistake which was required to be rectified by making the deduction of the proposed dividend from the general reserve as it stood on the first day of the respective previous years. The requirement of sec. 13 was, therefore, satisfied and the mistake was sought to be rectified as held by us hereinabove. In fact, the purpose of the rectification order was to deduct the proposed dividend from the general reserve as it stood on the first day of the

relevant previous year. In the process of such valid exercise of jurisdiction, the Assessing Officer took into consideration wrong amounts of dividends which were required to be deducted from the general reserve as on the first day of the previous year in respect of both the years. He, therefore, committed irregularity while exercising his jurisdiction to correct the original orders under sec. 13 of the Act. This resulted in wrong figures being deducted, namely, Rs. 16,38,000 instead of Rs. 29,25,000 from the general reserve of Rs. 1,61,83,570 as it stood on 1.4.1969 and Rs. 40,04,000 instead of Rs. 39 lakhs from the general reserve of Rs. 2,74,00,912 as it stood on the first day of the previous year, that is, on 1.4.1971 in respect of Assessment Year 1972-73. It will thus be seen that when the amount of Rs. 16,38,000 was deducted instead of deducting Rs. 29,25,000 which was the actual proposed dividend required to be deducted from the general reserve as on 1.4.1969, that has worked to the undue benefit of the assessee and the assessee cannot therefore make a grievance as to why lesser amount was, in fact, deducted. If at all it should be the Revenue which must feel aggrieved and should have got that figure raised to the actual amount of the proposed dividend of Rs. 29,25,000 by preferring an appeal before the Tribunal and seeking a direction on the first appellate authority in that regard in context of the provisions of sec. 11(4) of the said Act. The Revenue, however, did not bother or perhaps did not notice the revenue loss by such inadvertence of taking a wrong figure of the proposed dividend which was much lower than the real figure required to be deducted from the general reserve as it stood on 1.4.1969. The assessee obviously was not interested in getting that figure corrected. The assessee surely cannot claim that, even the lesser amount of Rs. 16,38,000, which the assessee itself had taken to be correct in the proceedings up till now, should not be deducted on the ground that the higher amount of Rs. 29,25,000 was deductible.

As regards the deduction of Rs. 40,04,000 from the general reserve as it stood on 1.4.1971 instead of Rs. 39 lakhs also, no one had so far disputed the correctness of the amount which was sought to be deducted in the rectification order. The assessee did not even allege that the actual figure was Rs. 39 lakhs and not Rs. 40,04,000, and, even if it wanted to do so, the remedy was to get the figure rectified at an appropriate stage.

In principle and on the question of law, our

opinion therefore is that the STO was within his jurisdiction to rectify the mistake but he committed an error in favour of the assessee by deducting lesser amount by way of proposed dividend from the general reserve as on 1.4.1969 and the assessee cannot challenge the same on the ground that some higher amount was liable to be deducted and since that was not done, even the lower amount should not be deducted. The assessee, as noted above, did not challenge the quantum figure of Rs. 40,04,000 on the ground that it was higher than the actual figure of Rs. 39 lakhs which was the dividend proposed for the year ending 31.3.1971. Therefore, since the validity of the rectification orders was not earlier challenged on these grounds of error in the amounts of the proposed to be deducted from the general reserve, the assessee cannot challenge the validity of the orders on such grounds in this Reference.

18. As a result of what we have stated hereinabove, we answer the two questions referred to this Court as under:-

1. The Tribunal was right in holding that the STO was well within his jurisdiction in passing the rectification orders, but failed to note that he committed an irregularity in exercise of his jurisdiction by taking a wrong figure of deduction of the proposed dividend from the general reserve as it stood on 1.4.1969 being the first day of the previous year 1969-70 relevant to the Assessment Year 1970-71, that is, Rs. 16,38,000 instead of Rs. 29,25,000, and by deducting a wrong figure of Rs. 40,04,000 instead of Rs. 39,00,000 as the proposed dividend from the general reserve as it stood on the 1.4.1971 being the first day of the previous year of 1971-72 relevant to the Assessment Year of 1972-73.

2. The Tribunal was right in upholding the validity of the orders on the grounds raised before it and it is not open to the assessee now to challenge the error in the rectification order, for the accounting year 1969-70 relevant to the Assessment Year 1970-71, of lesser deduction of Rs. 16,38,000 as against the deduction of Rs. 29,25,000 which has, in fact, resulted in undue benefit to the assessee nor can the assessee challenge the validity of the rectification order in respect of the Assessment Year 1972-73 on the ground that the actual proposed dividend was Rs. 39,00,000 and not Rs. 40,04,000 which was required to be deducted, since no such challenge was raised by the assessee before the Tribunal.

The reference stands disposed of accordingly with
no order as to costs.

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